

(6) and (d)(1) would have been \$90x). With respect to property N, the allowable percentage depletion pursuant to section 613A(c) before applying section 613A(d)(1) was \$80x (cost depletion would have been \$0). With respect to property O, the allowable cost depletion was \$60x (the allowable percentage depletion pursuant to section 613A(c) would have been \$70x, except that the application of section 613A(d)(1) reduced allowable percentage depletion to less than \$60x). With respect to property P, the allowable percentage depletion pursuant to section 613A(b) was \$55x (cost depletion would have been \$40x). With respect to property Q, which produces both gas subject to section 613A(b)(1)(B) and oil subject to section 613A(c), the allowable percentage depletion was \$45x (cost depletion would have been \$40x). With respect to property R, the allowable cost depletion was \$40x (the allowable percentage depletion pursuant to section 613A(c) would have been \$50x, except that the application of section 613A(c)(7)(A) reduced allowable percentage depletion to less than \$40x). Under paragraph (a)(1)(i) of this section, for purposes of applying the 65 percent limitation under section 613A(d)(1), F's taxable income must be reduced by the allowable depletion with respect to property M (for which cost depletion exceeded percentage depletion even in the absence of section 613A(c)(1), (6), and (d)) and property P (for which all depletion is determined pursuant to section 613A(b)), but shall not be reduced by the allowable depletion with respect to properties N, O, Q, and R.

(b) *Retailers excluded.* (1) Section 613A(c) and § 1.613A-3 shall not apply in the case of any taxpayer who is a retailer as defined in paragraph (r) of § 1.613A-7.

(2) The application of this paragraph may be illustrated by the following examples (those that involve sales through retail outlets assume, unless otherwise stated, that the \$5,000,000 gross receipts requirement section 613A(d)(2) is met):

*Example 1.* A, owner of producing oil and gas properties, also owns 5 percent in value of the stock of Corporation M, a retailer of oil and gas. None of A's production is sold through Corporation M. Since A may benefit from Corporation M's sales of oil and gas through A's ownership interest in Corporation M, A is considered to be selling oil or natural gas through Corporation M, a related person. Accordingly, the exemption under section 613A(c) does not apply to A, even though none of A's production is sold through Corporation M.

*Example 2.* Assume the same facts as in *Example 1* except that A has gross receipts of \$2

million from sales of oil for the taxable year from A's retail outlets and Corporation M has gross receipts of \$4 million from sales of oil for the taxable year from its retail outlets. For purposes of the \$5 million gross receipts requirement of section 613A(d)(2), A is treated as having gross receipts of \$6 million. Accordingly, the exemption under section 613A(c) does not apply to A.

*Example 3.* Corporation N, a retailer of oil and gas, owns 5 percent in value of the stock of Corporation O, owner of producing oil and gas properties. None of Corporation O's production is sold through Corporation N. Since Corporation O has no direct or indirect ownership interest in Corporation N, and therefore does not benefit from Corporation N's sales of oil and gas, and since none of Corporation O's production is sold through Corporation N, the exemption under section 613A(c) applies to Corporation O.

*Example 4.* Corporation P, a producer of oil, owns 70 percent in value of the stock of Corporation Q. Corporation Q owns 30 percent in value of the stock of Corporation R. Corporation R owns 30 percent in value of the stock of Corporation S, a retailer of oil and gas. P indirectly owns 6.3 percent (70 percent  $\times$  30 percent) in value of the stock of Corporation S. Since P may benefit from Corporation S's sales of oil and gas through P's indirect ownership interest in Corporation S, P is not entitled to percentage depletion.

*Example 5.* B is the owner of certain oil and gas properties in Texas and is also the owner of a service station in Washington, DC, which B leases to Corporation T. None of B's production is sold to Corporation T. The exemption under section 613A(c) applies to B. However, if sales of B's production were made to Corporation T and the gross receipts from such sales of B's production to Corporation T exceed 5 million dollars, the exemption under section 613A(c) would not apply to B because B is selling oil or natural gas to a person given authority to occupy a retail outlet leased by the taxpayer, B.

*Example 6.* C has a  $\frac{1}{8}$  royalty interest and Corporation U has a  $\frac{7}{8}$  working interest in an oil property. Corporation V, a retailer of oil, owns 5 percent in value of the stock of Corporation U. C has no interest in either corporation. All of the production from the property is sold through Corporation V, C receiving from Corporation U  $\frac{1}{8}$  of its receipts therefrom. The exemption under section 613A(c) does not apply to Corporation U because Corporation U is selling oil of natural gas through Corporation V, a related person that is a retailer. However, the exemption applies to C because C, as owner of a non-operating mineral interest, is not treated as an operator of a retail outlet merely because C's oil and gas is sold on C's behalf through a retail outlet operated by an unrelated person.